JURISDICTION: **OKLAHOMA TAX COMMISSION**
CITE: **2011-06-07-03 / NON-PRECEDENTIAL**
ID: **P-10-121-K**
DATE: **JUNE 7, 2011**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **NO APPEAL TAKEN**

ORDER

The above matter comes on for entry of a final order of disposition by the Oklahoma Tax Commission. Having reviewed the files and records herein, including the Findings of Fact, Conclusions of Law and Recommendations made and entered by the Administrative Law Judge on the 28th day of January, 2011, the Commission denies the Application of the Compliance Division for a hearing en banc and makes the following Findings of Fact and Conclusions of Law and enters the following order.

STATEMENT OF THE CASE

Based on Protestant's responses to a nexus questionnaire, the Compliance Division of the Oklahoma Tax Commission demanded that Protestant file Oklahoma income tax and franchise tax returns for years 2005, 2006 and 2007. On or about March 30, 2010, Protestant filed the income tax returns under protest.

On April 29, 2010, the Division referred the protest and its file to the Office of the Administrative Law Judges for further proceedings consistent with the Uniform Tax Procedure Code[1] and the Rules of Practice and Procedure before the Oklahoma Tax Commission[2]. The protest was docketed as Case No. P-10-121-K and assigned to ALJ, Administrative Law Judge.[3]

A pre-hearing conference was scheduled for June 10, 2010, by *Prehearing Conference Notice* issued May 14, 2010.[4] Pursuant to the conference, the parties were directed to file a status report. Upon *Status Report* filed June 21, 2010, a *Scheduling Order* was issued setting forth the procedure by which this matter would be submitted for decision.[5]

A *Joint Stipulation of Facts* and Exhibits A through I-3 were filed July 26, 2010. Protestant's *Brief in Chief* with attachments A and B were filed September 17, 2010. The *Division's Reply Brief* was filed October 7, 2010. Protestant's *Closing Brief* was filed

[1] 68 O.S. 2001, § 201 et seq.

[2] Rules 710:1-5-20 through 710:1-5-47 of the *Oklahoma Administrative Code* ("*OAC*").

[3] *OAC*, 710:1-5-22(b).

[4] *OAC*, 710:1-5-28.

[5] *OAC*, 710:1-5-28(b) and 710:1-5-38.

October 25, 2010. On November 12, 2010, the record was closed and the protest was submitted for decision.[6]

FINDINGS OF FACT

Upon review of the file and records, including the *Joint Stipulation of Facts*, the exhibits attached thereto and the pleadings of the parties, the undersigned finds:

A. The parties stipulate to the following[7]:

PROCEDURAL FACTS

1. In the spring of 2009, the Division identified [Protestant] as an entity with an account registered with the Oklahoma Employment Security Commission. Further investigation revealed the following Oklahoma address for [Protestant]: OKLAHOMA ADDRESS. Based on this information, the Division determined that [Protestant] had an Oklahoma income tax filing requirement.

2. By letters dated May 19, 2009, the Division mailed letters notifying [Protestant] of its filing requirement and requesting that [Protestant] file all required tax returns for the period of 2005 through 2007.

3. The Division received no response to its letters of May 19, 2009, and on November 18, 2009, issued letters of assessment to [Protestant] using the best information available to it at the time.

4. On or around December 1, 2009, the Division received a letter from [Protestant's representative], notifying the Division that [Protestant] had not received the May 19, 2009 notices.

5. A nexus questionnaire was sent to [Protestant]. [Protestant] completed the nexus questionnaire and the Division received the completed questionnaire on or around December 29, 2009.

6. Following review of the nexus questionnaire, the Division affirmed its determination of a filing requirement for [Protestant] and formally notified [Protestant] that it was required to file a Form 512S Oklahoma Income Tax and a Form 215 Franchise Tax Return for 2005 through 2007.

7. On or around March 30, 2010, the Division received [Protestant's] income tax and franchise tax returns. In conjunction with the filing of the returns, [Protestant] timely protested the Division's determination of nexus and its assessment of income tax.

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[6] *OAC*, 710:1-5-39.

[7] References to the exhibits attached to the *Joint Stipulation of Facts* are omitted.

8. As indicated by billing notices automatically generated and mailed to [Protestant] on April 17, 2010, the Division accepted the income tax returns filed by [Protestant]. The amount of income tax, interest, and penalty due was:

Tax Year	Tax Due	Interest	Penalty	Total
2005	$1,795.00	$1,101.35	$ 89.75	$2,986.10
2006	$1,789.00	$ 829.32	$ 89.45	$2,707.77
2007	$1,172.00	$ 367.01	$ 58.60	$1,597.61
Total	$4,756.00	$2,297.68	$237.80	$7,291.48

9. On or around May 4, 2010, [Protestant] paid under protest the income tax, interest, and penalty shown due on the 2005, 2006, and 2007 billing notices.

10. The Protest of [Protestant] is properly before the Commission.

GENERAL FACTS

11. [Protestant] manufactures and sells putty, glazing compounds, and allied paint products. Its headquarters are located in ANYTOWN, STATE.

12. [Protestant] had property, payroll, and sales in Oklahoma during the audit period, 2005 through 2007.

13. Since February 1998, [Protestant] has employed one employee, EMPLOYEE, in Oklahoma.

14. EMPLOYEE'S job title is "Technical Director." As described in the nexus questionnaire and the job description attached to the nexus questionnaire, EMPLOYEE'S duties include:

a. Carrying samples of PROTESTANT products;

b. Receiving business phone calls and maintaining an office at his home address;

c. Investigating complaints, trouble shooting, and/or giving advice to customers of PROTESTANT, regardless of customer location;

d. Providing product research and development activities and design work;

e. Providing product adjustments;

f. Providing technical and regulatory assistance to customers and regulators; and,

g. Providing product testing in general and problem solving for nonconforming products and failed products.

15. EMPLOYEE works out of his home located at OKLAHOMA ADDRESS. His home address is listed as an address for [Protestant], he receives business phone calls at his home address, stores inventory and samples there, and receives office expense reimbursement from [Protestant].

16. [Protestant] owns office and lab equipment which is located at EMPLOYEE'S home office and is used by EMPLOYEE to perform his duties as an employee of [Protestant].

17. EMPLOYEE retains and uses samples of [Protestant's] products from his home office.

18. [Protestant] files and pays Oklahoma payroll taxes.

19. EMPLOYEE files and pays Oklahoma income taxes.

B. Additional findings:

1. The historical costs of Protestant's property in Oklahoma is $12,915.00 which has been fully depreciated and represents less than one percent (1%) of the total of Protestant's tangible personal properties everywhere. Samples of Protestant's products in Oklahoma are used by Protestant's Oklahoma employee for testing, not to service Protestant's Oklahoma customer. Exhibits E, G-1 through G-3, and H.

2. Protestant's sales of its products to Oklahoma purchasers shipped from outside Oklahoma in tax years 2005, 2006 and 2007 totaled $25,027.00, $16,360.00 and $14,239.00, respectively. Protestant's Oklahoma sales represent less than one percent (1%) of Protestant's total sales everywhere. Exhibits G-1 through G-3.

3. Protestant's Oklahoma employee is the Technical Director of the company. As Technical Director, the employee participates in product research and development and support services. The employee is not a company sales representative. The Oklahoma employee is a highly compensated individual whose salary during the tax years in question ranged from 6.267 percent and 4.332 percent of the company's payroll. Exhibits E and G-1 through G-3.

ISSUES AND CONTENTIONS

Two issues are presented for decision. The first issue is whether Protestant sustained its burden of proving that it does not have an income tax filing requirement with the State of Oklahoma. The second issue is what method should be utilized by Protestant for reporting its income to the State of Oklahoma.

Protestant contends that it has no nexus, either physical or economic with the State of Oklahoma and to subject it to taxation in the State creates an undue burden on interstate commerce. In support of this contention, Protestant argues that but for an employee living in Oklahoma, it has no connection with the State. In the alternative, Protestant contends that the apportionment formula used to calculate Oklahoma taxable income should be modified to include only the property and sales factors. In support of this contention, Protestant argues that by including the payroll factor in the apportionment formula the income attributed to Oklahoma is out of all appropriate proportion to the property owned and business transacted in the State.

The Division contends that Protestant has failed to prove it does not have nexus with the State of Oklahoma under the Oklahoma Tax Commission Administrative rules. In support of this contention, the Division argues that whether Protestant has nexus with Oklahoma must be determined under Oklahoma law and that Oklahoma law does not ascribe to a "de mininus" standard. The Division further argues that the activities of Protestant's Oklahoma employee as well as its Oklahoma business location remove Protestant from the protection of P.L. 86-272. The Division further contends that Protestant's alternative to the payroll factor based on number of employees rather than payroll is not supported by law. In support of this contention, the Division argues that Protestant correctly calculated the apportionment factors and the Division accepted its returns as filed.

CONCLUSIONS OF LAW

WHEREFORE, premises considered, the undersigned concludes as a matter of law that:

1. Jurisdiction of the parties and subject matter of this proceeding is vested in the Oklahoma Tax Commission. 68 O.S. 2001, § 207.

2. An Oklahoma income tax is "imposed on the Oklahoma taxable income of every corporation doing business within this state or deriving income from sources within this state". 68 O.S. Supp. 2005, § 2355(D).

3. "No State, or political subdivision thereof, shall have power to impose, for any taxable year * * * a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)."

15 U.S.C. § 381(a).[8]

4. Pursuant to its authority to administer and enforce each and every provision of any state tax law, the Oklahoma Tax Commission promulgated subchapter 17 of chapter 50 of the Oklahoma Administrative Code which provides in pertinent part:

Oklahoma Taxable Income for Corporations

710:50-17-1. Corporate returns

(a) Any corporation doing business within or deriving income from sources within Oklahoma is required to file an Oklahoma Corporation Income Tax Return, whether or not a tax is due.

(b) Any corporation is subject to Oklahoma income taxes if it has "nexus" with Oklahoma. The purpose of this Subchapter is to provide guidelines for determining what constitutes "nexus", that is, what business activities are needed for any corporation to be subject to Oklahoma Income Taxes.

710:50-17-2. Definitions

The following words or terms, when used in this Subchapter, shall have the following meaning, unless the context clearly indicates otherwise:

"Business location" means a location which includes, but is not limited to: a repair shop, parts department, purchasing office, employment office, warehouse, meeting place for directors, sales office, permanent sample or display room, research facility or a recreational facility for use of employees or customers. A residence of an employee or representative is not ordinarily considered a **"business location"** of the employer unless the facts indicate otherwise. It could be considered a business location under one or more of the following conditions:

(A) a portion of the residence is used exclusively for the business of the employer;

(B) the employee's phone is listed in the business pages of a telephone directory under the name of the employer;

(C) the employee used supplies, equipment or samples furnished by the employer; or,

(D) the space is used by the employee to interview prospective employees, hold sales meetings, or discuss business with customers.

* * * * *

[8] Also known as P.L. 86-272.

"Solicitation" must be limited to the acts which lead to the placing of an order. The term does not include those acts which follow as a natural result of the placing of an order.

710:50-17-3. What constitutes "Nexus"

(a) If a corporation has one or more of the following activities in Oklahoma, it is considered to have "nexus" and shall be subject to Oklahoma income taxes:

(1) Maintenance of any business location in Oklahoma, including any kind of office.

(2) Ownership of real estate in Oklahoma.

(3) Ownership of a stock of goods in a public warehouse or on consignment in Oklahoma.

(4) Ownership of a stock of goods in the hands of a distributor or other non-employee representative in Oklahoma, if used to fill orders for the owner's account.

(5) Usual or frequent activity in Oklahoma by employee or representative soliciting orders with authority to accept them.

(6) Usual or frequent activity in Oklahoma by employee or representative engaged in a purchasing activity or in the performance of services (including construction, installation, assembly, or repair of equipment).

(7) Operation of mobile stores in Oklahoma (such as trucks with driver-salespersons), regardless of frequency.

(8) Other miscellaneous activities by employees or representatives in Oklahoma such as credit investigations, collection of delinquent accounts, conducting training classes or seminars for customer personnel in the operation, repair and maintenance of its products.

(9) Leasing of tangible property and licensing of intangible rights for use in Oklahoma.

(10) The sale of other than tangible personal property such as real estate, services and intangibles in Oklahoma.

(11) The performance of construction contracts or service contracts in Oklahoma.

(12) The delivery of merchandise in a company owned or leased vehicle to a destination within the state from a source outside the state, in connection with the solicitation of sales.

(b) The guidelines expressed in (a) of this Section as to what activities constitute "nexus" should not be considered all-inclusive. * * *

710:50-17-4. Federal limitations on taxation of foreign corporations

(a) Under Federal law a state may not impose its income tax on a business selling tangible personal property, if the only activity of that business is the solicitation of orders by its salesman or representative which orders are sent outside the state for approval or rejection, and are filled by delivery from a point outside the state. The activity must be limited to solicitation. If there is any activity which exceeds solicitation, the immunity from taxation is lost.

(b) Immunity from income taxation by states under Federal law does not extend to:

(1) Those businesses which sell services, real estate or intangibles in more than one state;

(2) Domestic Corporations;

(3) Foreign nation corporations, i.e., those not incorporated in the United States.

(c) If the only activities in Oklahoma of a corporation selling tangible personal property are those described below, the corporation is not subject to Oklahoma Income Taxes.

(1) Usual or frequent activity in Oklahoma by employees or representatives soliciting orders for tangible personal property, which orders are sent outside this state for approval or rejection.

(2) Solicitation activity by non-employee independent contractors, conducted through their own office or business location in Oklahoma.

5. Rules promulgated pursuant to the Administrative Procedures Act,[9] are presumed to be valid until declared otherwise by a district court of this state or the Supreme Court. 75 O.S. 2001, § 306(C). They are valid and binding on the persons they affect, have the force of law and are prima facie evidence of the proper interpretation of the matter to which they refer. 75 O.S. 2001, § 308.2(C).

The rules and regulations of an administrative agency which implement the provisions of a statute are valid unless they are beyond the scope of the statute, are in conflict with the statute or are unreasonable. See, ***Arkansas Louisiana Gas Co. v. Travis***, 1984 OK 33, 682 P.2d 225; ***Boydston v. State***, 1954 OK 327, 277 P.2d 138. Agency rules need not be specifically authorized by statute, but must generally reflect the intent of the Legislature as expressed in the statute. ***Jarboe Sales Company v. Oklahoma Alcoholic Beverage Laws Enforcement Commission***, 2003 OK CIV APP 23, 65 P.3d 289. As a general rule, it is presumed that administrative rules and regulations are fair and reasonable, and that the complaining party has the burden of proving the contrary by competent and convincing evidence. ***State ex rel. Hart v. Parham***, 1966 OK 9, 412 P.2d 142.

[9] 75 O.S. 2001, § 250 et seq., § 301 et seq.

6. The net income of a unitary business (after allocations not at issue here) shall be apportioned to this state on the basis of the arithmetical average of three factors consisting of property, payroll and sales or gross revenue. 68 O.S. 2001, § 2358(A)(5). In any case where the apportionment of the three factors prescribed in this paragraph attributes to Oklahoma a portion of net income of the enterprise out of all appropriate proportion to the property owned and/or business transacted within this state, because of the fact that one or more of the factors so prescribed are not employed to any appreciable extent in furtherance of the enterprise; or because one or more factors not so prescribed are employed to a considerable extent in furtherance of the enterprise; or because of other reasons, the Tax Commission is empowered to permit, after a showing by taxpayer that an excessive portion of net income has been attributed to Oklahoma, or require, when in its judgment an insufficient portion of net income has been attributed to Oklahoma, the elimination, substitution, or use of additional factors, or reduction or increase in the weight of such prescribed factors. Provided, however, that any such variance from such prescribed factors which has the effect of increasing the portion of net income attributable to Oklahoma must not be inherently arbitrary, and application of the recomputed final apportionment to the net income of the enterprise must attribute to Oklahoma only a reasonable portion thereof.

DISCUSSION AND ORDER

P.L. 86-272, codified at 15 U.S.C. § 381,prohibits a state from imposing an income tax on entities whose only activities in a state are solicitation of orders and, as construed by the United States Supreme Court in *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 112 S. Ct. 2447 (1992), activities which are entirely ancillary to soliciting orders. The stipulated facts in this case show that protestant's Oklahoma employee's job duties included activities which were neither solicitation of orders nor were ancillary to solicitation of orders. Specifically, protestant stipulated that its employee's duties included investigating complaints, trouble shooting, and/or giving advice to customers of PROTESTANT, regardless of customer location; providing product research and development activities and design work; providing product adjustments; providing technical and regulatory assistance to customers and regulators; and providing product testing in general and problem solving for nonconforming products and failed products. These activities are neither solicitation of orders nor are they activities which are ancillary to solicitation of orders. P.L. 86-272 does not prohibit the imposition of state income tax in this case.

The Oklahoma Tax Commission Rule which provides for the determination of nexus, OAC 710-50-17-3, does not include any consideration of intent or design of the entity being considered. The rule is presumed to be constitutional. The Oklahoma Tax Commission as a state agency has no authority to determine that the rule is unconstitutional. The Division has asserted that the protestant engages in three of the activities listed in OAC 710:50-17-3 as constituting nexus. Those activities are maintenance of a business location in Oklahoma, usual or frequent activity in Oklahoma by employee in the performance of services, and other miscellaneous activities by employees such as conducting training classes or seminars for customer personnel in the operation, repair and maintenance of its products. The stipulated facts provide "substantial evidence" of each of these activities. The burden of proof is on the protestant to show by the preponderance of the evidence that it has not engaged in any of these activities. Protestant has failed to meet that burden of proof.

When the use of the three statutory apportionment factors (property, payroll and sales) does not result in the income of an entity being fairly and appropriately apportioned to this state, the provisions of the Oklahoma statute provide for the modification of the statutory apportionment formula. The burden of proof of showing that such factors do not fairly and appropriately apportion the income is on the protestant. In this case there is no admissible evidence in the record showing that the statutory factors do not fairly and appropriately apportion the protestant's income to this state. The protestant has failed to meet its burden of proof on this issue.

The Oklahoma Tax Commission orders that the protest in this matter be denied.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was NOT deemed precedential by the Commission. This means that the legal conclusions are generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.

NOTE: The distinction between a Commission Order designated as "Precedential" or "Non-Precedential" has been blurred because all OTC Orders resulting from cases heard by the Office of Administrative Law Judges are now published, not just "Precedential" Orders. *See* OKLA. STAT. ANN. tit.68, § 221(G) (West Supp. 2009) and OKLA. STAT. ANN. tit. 75, § 302 (West 2002). *See also* OTC Orders 2009-06-23-02 and 2009-06-23-03 (June 23, 2009), which also conclude the language of the Statute is "clear and unambiguous."